CANADA'S ENERGY FUTURE

Action Today for a Secure Tomorrow

The sudden dramatic decline in oil prices is placing the security of Canada's energy future in jeopardy. While consumers benefit from low prices in the short term, major investments in Canada's oil and gas industry have been slashed. This has had a disastrous effect on regional economies. In fact, jobs in many sectors across Canada are disappearing.

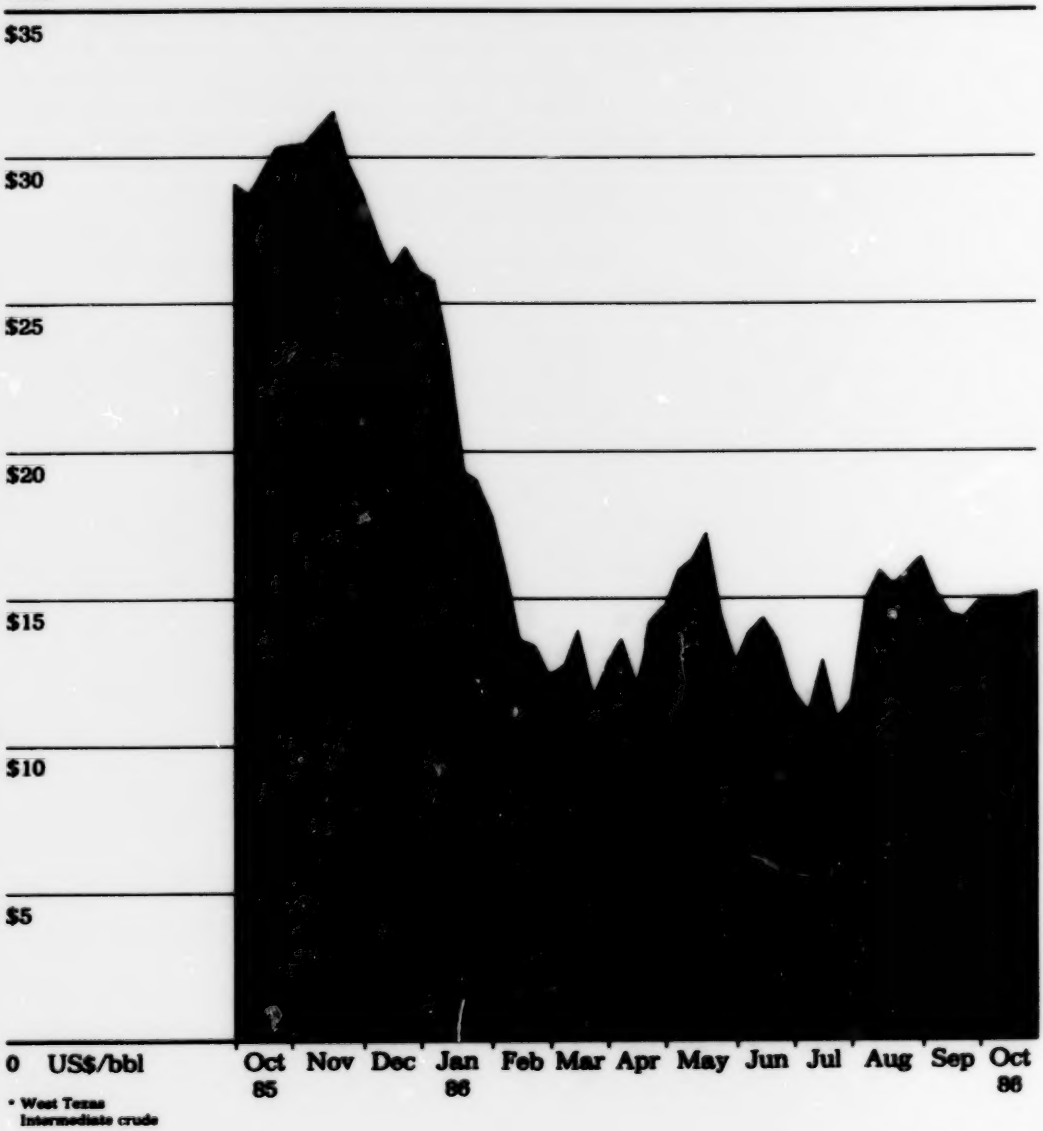
Equally disturbing is the growing trend that will see Canada importing one-quarter of its light crude oil needs within four years. Without new Canadian sources of supply by the turn of the century — in just 13 years — every second barrel of oil consumed in Canada will be produced in another country. Canada, a country with the opportunity to be energy self-sufficient, to have its own domestic, secure oil supply, will have placed its energy future in the hands of foreign suppliers.

The future supply of oil for Canada is a national issue. This booklet explains why.

What has happened to international oil prices during the past year?

International oil prices were cut in half between November 1985 and April 1986. They remain volatile and unpredictable. Price swings of up to 65 per cent have occurred within a matter of weeks.

International Oil Prices*
October 1985 to October 1986 (US$)



* West Texas Intermediate crude

What caused this price collapse and volatility?

International oil supplies have increased, while demand has decreased. The Organization of Petroleum Exporting Countries (OPEC), primarily through the actions of Saudi Arabia, controlled prices by restricting production. In late 1985, Saudi Arabia led OPEC to change its policy and increase production by over two million barrels of oil a day, flooding world markets.

Oil producers were forced to rapidly cut prices in order to hold on to their markets. Canadian prices fell too since Canadian oil from Western Canada competes with international oil in both Canadian and American markets.

Oil prices continue to bounce up and down with the latest OPEC rumour or policy statement.

3
Has the oil price fall had a positive or negative effect on Canada's economy?

In 1985, the oil and gas industry accounted for 20 per cent of business capital investments in Canada. The depth of the price fall has had a disastrous effect on the industry's revenues resulting in investment being slashed almost in half — by $4.5 billion.

Not surprisingly, this has had a major negative effect on the Canadian economy. Early in 1986, virtually all economic forecasts showed Canada benefitting from lower oil prices. Later in the year, it was a different story!

Slower economic growth

"Business investment declines because of the harmful effects of lower oil prices on energy projects are likely to outweigh the positive benefits of non-energy projects..." Conference Board of Canada, March 1986.

"Canada may not get much benefit out of lower oil prices; indeed we may end up in worse shape — at least this year. Many economists have been shaving their growth estimates for this year..." Financial Post, July 5, 1986.

"Sharply reduced outlays in the energy sector have more than offset significant gains in other areas such as manufacturing." Royal Bank, October 1986.

The federal government has revised the growth outlook for Canada's real Gross Domestic Product from 3.7 per cent to 3 per cent primarily due to lower oil and grain prices.

A very cold, hard reality for thousands of Canadians. They are losing their jobs.

Thousands of jobs lost in Alberta

Worst hit is Alberta. A recent survey has shown that 25,000 jobs in the oil and gas industry and related jobs in manufacturing firms could be lost this year. This represents one-quarter of the employment in Alberta's oil and gas industry. Imagine the devastating impact if Ontario lost one-quarter of the jobs in the auto industry in less than a year!

As Alberta oil industry jobs disappear and consumer spending shrinks, more job losses will occur throughout the province.

Jobs lost throughout Canada

No region of Canada is left untouched by the industry downturn. In Ontario, thousands of manufacturing jobs are affected by reduced energy industry orders. As an example, steel mills supplying pipe and tubular steel to the oil and gas industry have announced steady layoffs throughout this year. Suppliers to the oil industry from Sault Ste. Marie, Ontario to Upper Musquodoboit, Nova Scotia, are all hurt when the oil industry suffers.

Job losses directly related to the fall in crude oil prices and the drop in drilling will be devastating in some regions. In the Northwest Territories, over 2,000 jobs have been lost. On the East Coast, the bright future which offshore resources promised has faded as over 2,500 drilling and related jobs have been lost with the slowing of offshore exploration.

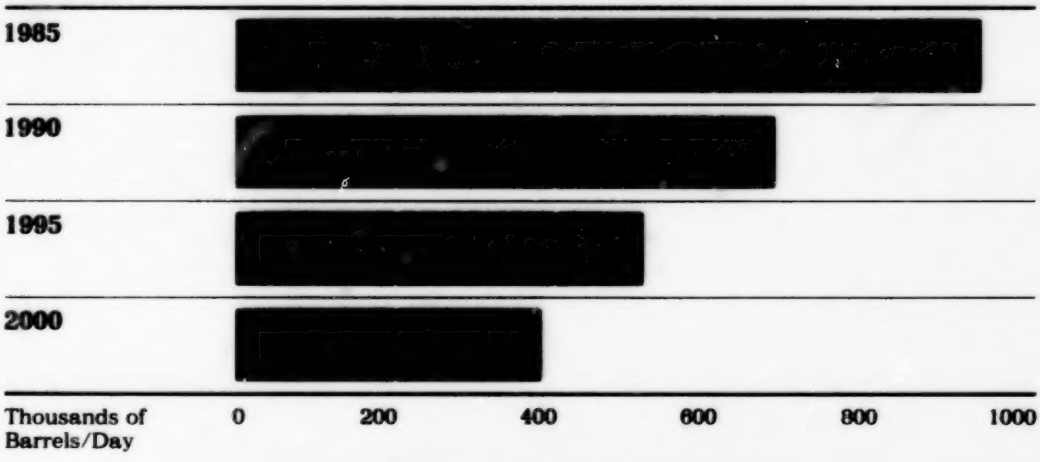
In addition to the jobs lost in Alberta, thousands of jobs will be lost in the rest of Canada.

Right now, it means consumer savings for petroleum products. Five years from now, it means that a lot less petroleum products will be made from Canadian crude. Canadian consumers will soon become dependent on foreign suppliers of crude oil in spite of having some of the world's largest energy reserves.

Canadian refiners depend on light crude oil to produce the range of petroleum products which fuel our cars, trucks and airplanes, heat our homes, and drive our industries. Production of light crude oil in Alberta is declining rapidly.

The bulk of Canada's light crude oil production comes from Alberta's conventional fields. Over the years, these fields have been prolific producers, but their rate of production must inevitably decline. The industry has invested a great deal of money in improving the efficiency with which oil is extracted, but the large, older fields have already started to dry up. The overall effect is a rapid drop in the production of the light crude needed by Canadian refiners.

Alberta Conventional Light Oil Production



Yes. Canada is endowed with many potential new sources of light crude. These include development of the oil sands in Alberta, upgrading of heavy oils in Alberta and Saskatchewan, the Hibernia field off Newfoundland and the Beaufort Sea in the North. The future of these energy projects is uncertain.

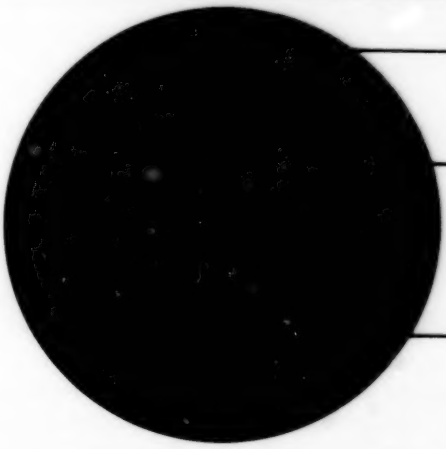
Two out of three Canadians could be reliant on foreign suppliers

Without investment in new sources of crude oil supply, Canada will be importing one-quarter of its total light oil needs in four years. This dependence could grow to 50 per cent by the turn of the century. People in Atlantic Canada, Quebec and Ontario – two out of every three Canadians – could be reliant on foreign suppliers for their crude oil. They will be subject to potential supply interruptions in the event of conflicts in other parts of the world. Large increases in imports will also hurt Canada's trade balance.

Sources of Canadian Light Crude Oil Supply*

Year 1990

Year 2000



* Based on Canadian demand for crude oil remaining constant at 1985 levels.

The first requirement is to maintain a healthy oil and gas industry. This includes ensuring the survival of smaller Canadian companies – among the most dynamic in the industry.

Alberta incentives total $1.6 billion

The Government of Alberta has shown leadership and acted. Particular attention has been given to the smaller, Canadian-owned exploration and service businesses which have been hardest hit by the oil price drop. Since oil prices have declined, Alberta has announced incentives of $1.6 billion. The largest portion involves a major reduction in oil and gas royalties. In addition, all royalty payments have been eliminated for a five-year period on new oil wells drilled after October 1, 1986. This program will help strengthen the viability of the energy sector, stimulate new activity and investment, create jobs and contribute to energy security.

PGRT removed

The federal government has co-operated with producing provinces in deregulating the industry. Recently it removed the Petroleum and Gas Revenue Tax (PGRT) under which the oil and gas industry had been unfairly taxed on the basis of its gross revenues. Elimination of the PGRT restores fairness and enables the industry to retain approximately $800 million. It finally brings to an end the ill-conceived National Energy Program which devastated the western energy producing provinces.

These recent remedial measures will greatly assist the conventional drilling industry. However, they are not enough to guarantee that new sources of crude oil will be developed in Canada during the next decade.

Recognizing this, Alberta has taken short-term measures to keep the momentum going on the Syncrude and Husky projects. An interest free loan of $85 million has been offered to Syncrude to undertake basic engineering and planning for their expansion project. In partnership with the federal and Saskatchewan governments, $63 million has been provided to Husky Oil to continue the engineering design for the Bi-Provincial Heavy Oil Upgrader.

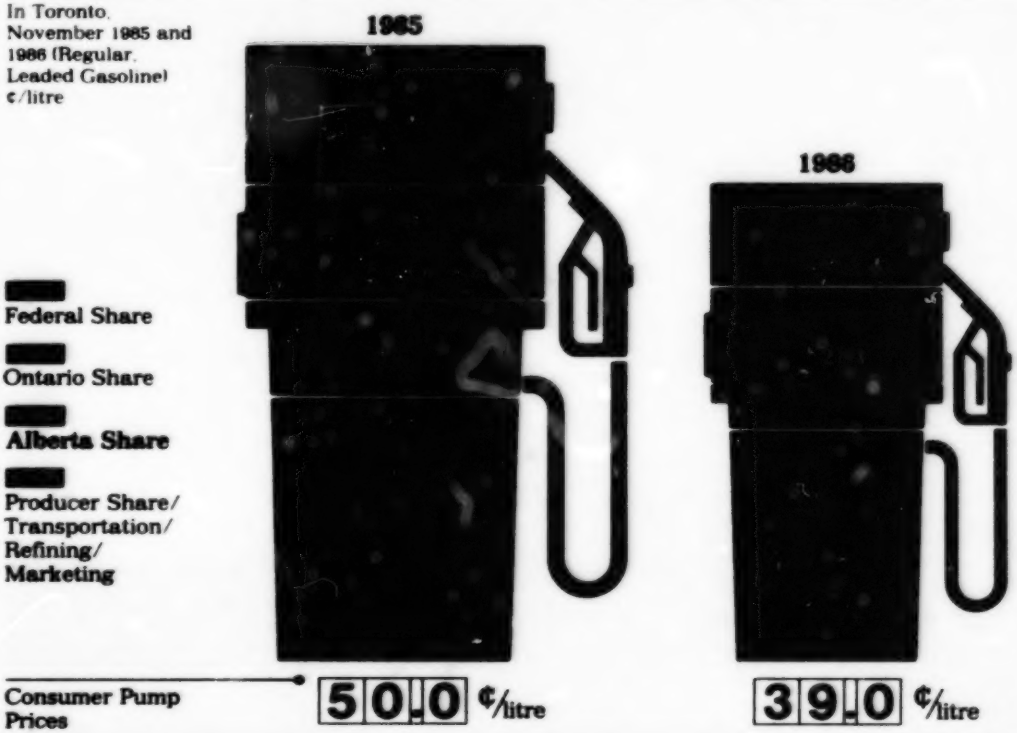
Since 1974, when oil prices began escalating, the people of Alberta have sacrificed by shielding Canadians from higher oil prices. This has cost Albertans an estimated $56 billion in foregone revenue.

The Government of Alberta has also saved a portion of the province's non-renewable resource revenues for future Albertans. The Alberta Heritage Savings Trust Fund was created in 1976. A major objective is to strengthen and diversify Alberta's economy. To help achieve this, $500 million has been invested in the energy sector, thereby contributing to Canada's energy future. However, the decline in revenues from the sale of natural resources has forced Alberta to restrict the growth of the Fund and use the Fund's income for general revenue purposes.

Now that oil prices have dropped, it is the industry and governments of producing provinces that are bearing most of the costs. If you consider the price of gasoline at the pump, Alberta's share has dropped considerably. Alberta, which owns the non-renewable resource, now receives less than half of what the consuming provinces and the federal government each take from every litre of gasoline made from Alberta crude. In Quebec, Ontario, Manitoba and British Columbia, the provinces and the federal government now get four times the revenue that Alberta does!

Comparison of Revenue Shares from the Sale of a Litre of Gasoline

In Toronto, November 1985 and 1986 (Regular, Leaded Gasoline) ¢/litre



Is the problem a national one?

Premiers agree

Yes. At the Annual Premiers' Conference in Edmonton in August 1986, and at a later meeting of provincial Ministers of Energy in September, the provinces unanimously agreed that the "situation facing the industry is a national problem and requires a national solution."

A positive environment for energy investment needed

Today, Canada is at an energy crossroads. No one could suggest that a trading nation like Canada could insulate itself from major international commodity prices. But governments must work to provide a more favourable environment in which the necessary investments in Canada's energy future can be made.

Projects which could contribute significantly to Canada's crude oil supply include oil sands plants, heavy oil upgraders, Hibernia and Beaufort Sea development. These projects require large amounts of capital – $3 to $5 billion each. It will take up to seven years to deliver oil from these projects, to generate a cash flow, and even longer to earn a rate of return on such substantial investments. This poses a major risk for investors.

Fiscal policies must reflect the uniqueness of the energy industry. Its high risk, need for capital and essential nature must be recognized in the tax system. Its treatment must be at least as favourable as that of the mining industry. For the major energy projects, governments must consider special tax treatment as well as sharing the risk.

Canadians should be concerned about these energy matters.

Balanced growth in Canada

New energy supplies mean more to us than just the flow of Canadian crude oil into Canadian refineries. These new supply projects generate jobs for Canadians, especially in those regions currently suffering from the slowest economic growth and the highest unemployment in the nation. The C.D. Howe Institute has recently warned that the fabric of Canadian Confederation will be weakened if the increasing regional imbalance in growth is not addressed.

Economic benefits for all Canadians

New crude oil projects in the North, Atlantic and Western Canada also mean jobs and income for Ontario and Quebec. Alberta's Syncrude oil sands plant has a current $1.5 billion capital expansion program which could average 90 per cent Canadian content in the supply of goods and services.

Regional Income Effects of Construction Expenditures

(by Percentage)
For New Energy Supply Projects

The Husky Bi-Provincial Upgrader is another example of a project which can be a major job creator throughout Canada. Husky estimates that more than half of the necessary equipment for the project will be purchased in Ontario and generate 2,200 manufacturing jobs in that province alone.

Permanent jobs

Major job opportunities are not confined to construction. Syncrude estimates that its annual spending on day-to-day operations generates 6,750 jobs outside Alberta.

Technology

The technology developed by the Canadian industry to undertake energy projects is recognized as the most advanced in the world. Canada cannot afford to lose the talents of its scientists, engineers and technicians who have developed this technology. Canadian suppliers to these projects have been able to develop new products and new markets. Similar economic opportunities will be lost if these projects are not built.

A natural advantage

Canada currently has an enviable advantage over most other industrial nations. We have the potential to remain self-sufficient in all forms of energy including oil. Our competitors simply do not enjoy that alternative. Canadians must carefully consider whether they want to throw that advantage away.

Energy security

New sources of light crude oil should be considered insurance for our country against the threat of future international supply disruptions. Canadians should be concerned about the potential costs of not having this insurance.

With the prospect of prolonged instability in the international oil market, Canada faces a critical energy challenge. Canadians must insist now that security of supply is a national priority. A domestic oil supply brings jobs, balanced growth and new technology. Canadians should be concerned that these opportunities are not lost.

Additional copies of
"Canada's Energy Future: Action Today for a Secure Tomorrow"
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